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PRINT Back to story

Time magazine: Rising inequality 'overblown'

By Zachary Roth
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Is income inequality on the rise in America? Most observers--citing figures such as the income of the top 1 percent nearly quadrupling since 1980, while that of the middle class has stayed flat--think it is. But Time magazine, relying on the minority view of a scholar with the libertarian Cato Institute--seems to disagree.

A new essay by Time's David Von Drehle--intended as a counter to recent hand-wringing over the future of the American economy--calls concern over inequality "overblown." Von Drehle asserts that much of the change is an "illusion," caused simply by alterations to the tax code, which have led the very rich to report more business earnings as personal income, but don't reflect the underlying reality of wealth distribution.

Here's Von Drehle's argument in full:

And some of the most cited symptoms [of American decline] are overblown. Take the much discussed problem of income inequality. A very small number of superwealthy people are pocketing nearly all *the growth in our national income. That sounds dire for a nation founded on the ideal of equality. It isn't, though, for a couple of reasons. First, a significant part of the rise in inequality is an illusion. Changes to the tax code since the 1980s have created strong incentives for owners of private businesses and certain partnerships to report their business earnings as personal income. This didn't necessarily change the amount of money in their pockets; it just meant that money is recorded in a different column of Uncle Sam's ledger. This expansion of so-called Subchapter S corporations and LLCs inflated the tax returns of the very rich — primarily the top 0.5% of all taxpayers. If the tax laws are changed again, money will shift again. Count on that.*

If Von Drehle and Time are correct and income inequality isn't really growing as steeply as the consensus holds, it would be a big deal, with major implications for tax and social policy. That's why it's a bit odd that this challenge to the conventional wisdom comes in a mere paragraph that's part of a larger piece, and cites no actual research in support. But let's leave that aside.

Although Von Drehle doesn't acknowledge it, his argument comes directly from the work of Alan Reynolds, of the libertarian Cato Institute, who has long argued that inequality isn't really happening. Here's what Reynolds wrote last fall:

In a forthcoming paper for the Cato Journal I use data from [economists Thomas] Piketty and [Emanuel] Saez to show that most growth of top 1% incomes since the 1986 tax reform has been the result of shifting income from corporate tax forms to individual tax forms (by using Subchapter S corporations, partnerships and LLCs) when individual tax rates fell in 1987 and 2003. There were also unusually large increases in reported capital gains and dividends after those tax rates were cut in 1997 and 2003.

Piketty and Saez teach at the University of California at Berkeley and the Paris School of Economics, respectively. Saez also is a recipient of the prestigious John Bates Clark Medal, and a MacArthur fellow. They conducted much of the key research that over the last decade has established inequality as a growing problem.

And, to put it mildly, they don't agree with Reynolds. When he made a similar argument in 2007, they responded that his critiques "contain serious misunderstandings of our academic work."

More broadly, it's fair to say that most experts don't endorse Reynolds's claim, echoed by Von Drehle, that inequality isn't happening to a significant degree.

"Even without that change in the tax code, we would have had increasing inequality--no question about that in my mind," Isabel Sawhill, a fiscal policy expert at the Brooking Institution, who has written extensively about inequality, told The Lookout. Sawhill described Reynolds as "an advocate for a particular point of view," that's "a minority view."

And as the liberal economist Mark Thoma has pointed out, a slew of conservative economists of unimpeachable academic credentials--including Martin Feldstein of Harvard, Glenn Hubbard, who was President Bush's top economics adviser, and Federal Reserve chair Ben Bernanke--have all acknowledged that inequality is on the rise.

Of course, Reynolds could be right, and the others wrong. But even a cursory survey of the research makes clear that the weight of the evidence lies on the other side. That's not the impression you'd get from Von Drehle, who simply asserts Reynolds's minority view as if it were fact.

Von Drehle did not respond to a request for comment.

(Angel Aponte begs for spare change on Wall St. outside the New York Stock Exchange, October, 1994.: Mark Lennihan/AP)
